

# Red Flags of Fraud What to look for and where!



Novotel Wollongong  
Friday 9<sup>th</sup> September 2011

**IMPACT**  
Forensics

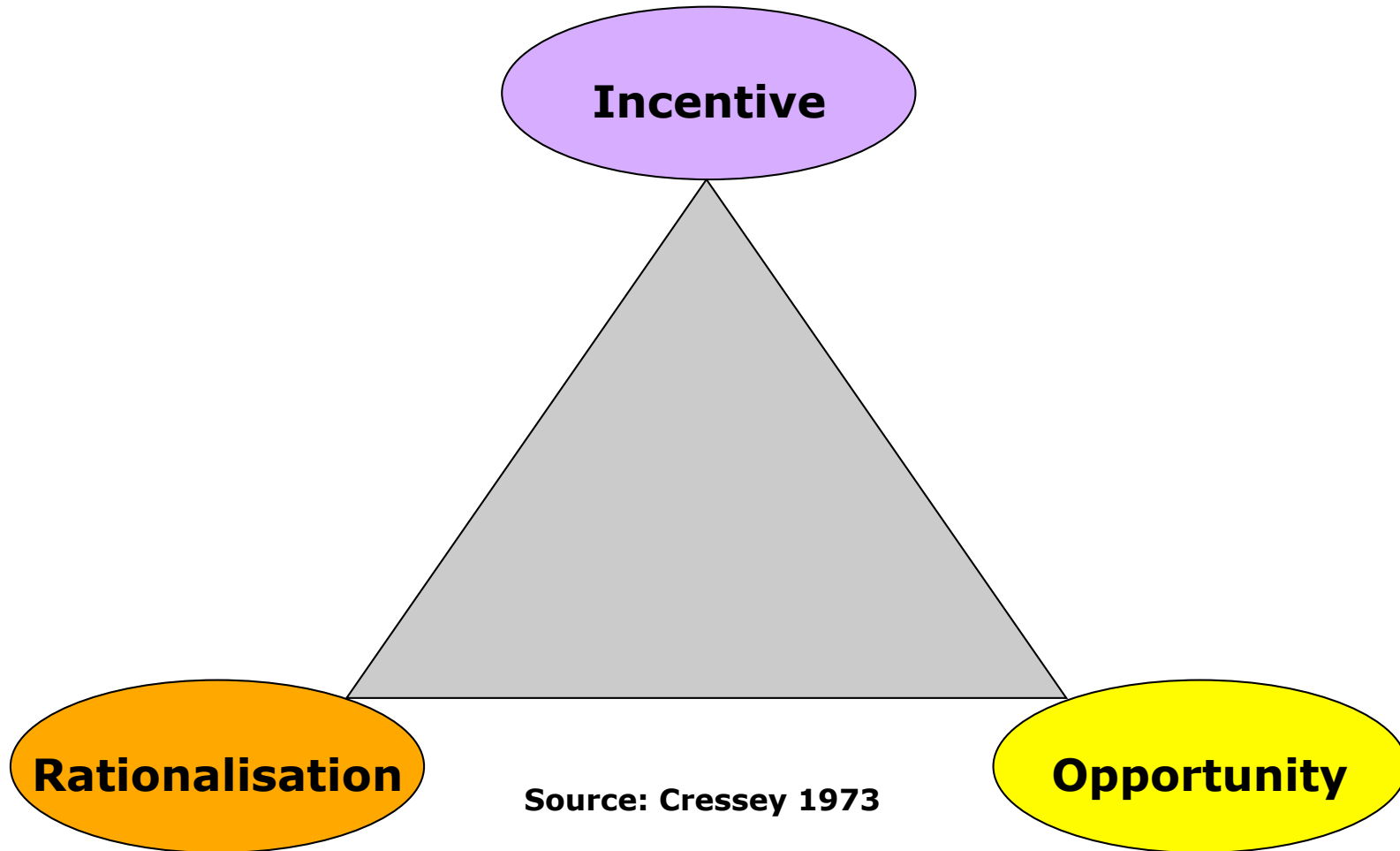
Level 1, 125-131 Crown Street, Wollongong NSW 2500  
PO Box 5336, Wollongong NSW 2520



# What is fraud?

- Fraud is a generic term
- An *intentional or reckless false representation* about a *material* point which is *believed* and *acted upon* by the victim to the victim's *damage*.
- *The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organisation's resources or assets*

# The Fraud Triangle



# Types of Fraud

- Excluding financial services industry related fraud, the five most common types of fraud against companies in Australia are:
  - False invoicing
  - Theft of inventory
  - Theft of cash receipts
  - Theft of plant and equipment
  - EFT fraud

# Who is Fraud Perpetrated Against?

- It is assumed that big business (and Financial Services industries) bear the brunt of the cost of fraud in Australia
- These businesses have better internal controls
- SMEs actually incur a greater median loss than large businesses
- Due to lower standards of internal control

# SME Fraud Risk

- SME characteristics
  - Hands on approach to business
  - Fewer staff with greater responsibility
  - Fewer internal controls due to nature of business
  - Often a growing business
  - Personal and emotional investment

# SME – Fraud Risks

- Poor systems
- Growth
- Unregulated markets
- Lack of internal controls
- Reliance on external audit
- Belief that fraud risk is negligible
- Trust – (informal controls)

# Red Flags of Fraud

- An indicator that fraud may be present
- Don't guarantee its presence
- May be innocent, but may point toward something more sinister
- The AIC identifies 3 types
  - Behavioural
  - Organisational
  - Statistical



# Behavioral Red Flags

- The behavior of the individual may be an indicator.
  - Not taking leave
  - Lavish gifts
  - A “Wheeler and Dealer”
  - Lack of a strong code of personal ethics

# Organisational Red Flags

- Relates to traits of an organisation and can relate to the susceptibility of the business to fraud, or propensity to commit fraud.
  - Culture
  - High employee turnover

# Statistical Red Flags

- Often the way that fraud is discovered
- The result of analysing data collected by the organisation(s).
  - Excessive overtime paid
  - Reduction in revenue
  - Increase in expenditure

# How Many Red Flags is OK?

- One red flag on its own may be an anomaly
- But when the number of flags begins to mount, closer scrutiny is required





**Bernard L. Madoff**



**COMPANY**  
Bernard L. Madoff Securities

**CRIME**  
Ran a Ponzi scheme for decades and defrauded investors out of billions of dollars.

**PLEADED GUILTY**  
March 2009

**WHERE HE IS NOW**  
Awaiting prison assignment.

**Red Flag**

Returns too consistent  
Whistleblower for 7 years



**Lance K. Poulsen**



**COMPANY**  
National Century Financial Enterprises

**CRIME**  
Committed a \$3 billion fraud that led to the downfall of the company.

**CONVICTED**  
October 2008

**WHERE HE IS NOW**  
Has not been assigned a prison yet.

**Red Flag**

Disclosures pointing to stress and questionable dealings, accusations



**Bernard J. Ebbers**



**COMPANY**  
WorldCom

**CRIME**  
Masterminded an \$11 billion accounting fraud.

**CONVICTED**  
March 2005

**WHERE HE IS NOW**  
Minimum security federal prison in Oakdale, La.

**Red Flags**

Lack of transparency  
Dominant CEO



**Jeffrey K. Skilling**

**SENTENCE**



**COMPANY**

Enron

**CRIME**

Committed fraud and conspiracy to mislead shareholders and regulators.

**CONVICTED**

May 2006

**WHERE HE IS NOW**

Minimum security federal prison in Littleton, Colo.

Red Flags

The old rules don't apply

To good to be true

Lack of transparency (SIVs)



**Samuel Israel III**

**SENTENCE**



**COMPANY**

Bayou Group, a hedge fund

**CRIME**

Cheated investors out of more than \$400 million

**PLEADED GUILTY**

September 2005

**WHERE HE IS NOW**

Awaiting transfer to a federal prison.

Red Flags

Lack of due diligence despite promise to do so

Audited?



**John J. Rigas**

**SENTENCE**



**COMPANY**

Adelphia Communications

**CRIME**

Looted the company he founded and hid more than \$2 billion of its debt.

**CONVICTED**

July 2004

**WHERE HE IS NOW**

Minimum security federal prison in Butner, N.C.

Red Flags

Backdated contracts

Middle management whistleblowers under pressure



**Walter A. Forbes**

**SENTENCE**



**COMPANY**  
Cendant

**CRIME**  
Committed fraud and conspiracy to mislead shareholders and regulators.

**CONVICTED**  
October 2006

**WHERE HE IS NOW**  
Minimum security federal prison in White Deer, Pa.

Red Flags

Accounting irregularities to overstate sales



**Sanjay Kumar**

**SENTENCE**



**COMPANY**  
CA (Computer Associates)

**CRIME**  
Orchestrated a \$2.2 billion accounting fraud that inflated sales for 1999 and 2000.

**PLEADED GUILTY**  
April 2006

**WHERE HE IS NOW**  
Medium security federal prison in south central New Jersey

Red Flags

Backdated contracts  
'the dating game'



**L. Dennis Kozlowski**

**SENTENCE**



**COMPANY**  
Tyco

**CRIME**  
Looted the company and deceived investors.

**CONVICTED**  
June 2006

**WHERE HE IS NOW**  
Medium security state prison in Marcy, N.Y.

Red Flags

Personal use and looting of company assets

# Winner ! Sonya Causer



- **Sonya Causer** sits proudly in the Holden SportWagon she successfully bid for in the Royal Children's Hospital Good Friday Appeal Online Auction last year.
- In total she bought **43 properties**, including five in suburban Brisbane and one in Tasmania
- The payroll manager of troubled whitegoods and electrical retailer Clive Peeters has admitted she **used \$20 million in company funds** on a spending spree over 18 months

# Current Market!!!

- Unfavourable(?) economic conditions
- Insufficient working capital
- High debt
- Profit squeeze

Conditions Are Perfect...

# Number 1 Red Flag

Tips, complaints or allegations about fraud

# Conclusion

- Fraud is pervasive, invasive and expensive
- Awareness of potential Red Flags for the business and vigilance in red flag monitoring can reduce the risk of occurrence and reduce the time for detection.
- Vigilance is key



# AML/CTF and Your Practice!

- What is it and how will it effect your practice?
  - If you provide a “designated service”, you must comply.
  - Compliance is not necessarily a tick and flick approach... it will take planning.
  - Everyone in this room needs to consider their need to comply.

# When?

- Beats me

# But it will happen...

- The Financial Action Task Force on Money Laundering (FATF) mutual evaluations = pressure.

# Be Ready

- Understand your designated services
- Understand your structure and reporting requirements
- Consider training and other compliance aspects
- Consider developing your Program A and B in readiness
- Each year your compliance needs to be *independently* audited.

Thank you

